

## Message Text

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ACTION TRSE-00

INFO OCT-01 EA-06 ISO-00 NEA-09 IO-10 H-01 L-02 PRS-01

PA-01 USIA-06 SP-02 AID-05 EB-07 NSC-05 RSC-01

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FRB-03 INR-07 NSAE-00 XMB-02 OPIC-03 LAB-04 SIL-01

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FM AMEMBASSY MANILA

TO SECSTATE WASHDC 9977

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USADB

TREASURY FOR ZINMAN

E O 11652: ADS, DECLAS 6/30/75

TAGS: EAID, EFIN

SUBJ: PROPOSED INCREASE IN ADB ORDINARY CAPITAL LENDING RATE

SUMMARY: ADB MANAGEMENT PROPOSES INCREASE IN ORDINARY CAPITAL LENDING RATE FROM 8-1/4 PERCENT TO 8-3/4 PERCENT AS WELL AS INCREASE FROM 8-1/4 PERCENT TO 9-1/2 PERCENT FOR DEVELOPING MEMBER COUNTRIES WITH 1972 PER CAPITA GNP IN EXCESS OF \$850, I.E., SINGAPORE AND HONG KONG. BASIC JUSTIFICATION FOR INCREASE IS HIGHER THAN ANTICIPATED AVERAGE BORROWING COST FOR ADB. USADB SUPPORTS PROPOSALS.

1. BANK DOCUMENT R5-75, "REVIEW OF BANK'S LENDING RATE," POUCHED 15 JAN. PROPOSES INCREASE IN ORDINARY CAPITAL LENDING RATE FROM 8-1/4 PERCENT TO 8-3/4 PERCENT TO BE EFFECTIVE AS OF DATE OF BOARD CONSIDERATION AND LIMITED OFFICIAL USE

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APPROVAL CURRENTLY SCHEDULED FOR 4 FEB. 1975.

BANK PROPOSES AS WELL THAT INTEREST RATE OF 9-1/2 PERCENT APPLY TO BANK ORDINARY CAPITAL LOANS TO DEVELOPING MEMBER COUNTRIES WITH PER CAPITA GNP IN EXCESS OF (350 AS OF END OF 1972. FINALLY, BANK PROPOSES THAT 8-3/4 PERCENT INTEREST BE APPLIED TO ALL BANK CREDITS FOR NATIONAL DEVELOPMENT BANKS' SUBLOANS FOR PROJECTS ON WHICH APPLICATION FOR LOAN AND SUPPORTING DOCUMENTS ARE RECEIVED AFTER REPEATE AFTER EFFECTIVE DATE OF INTEREST RATE INCREASE. FOR ALL SUCH DEVELOPMENT BANK SUBLOANS FOR WHICH APPLICATION AND SUPPORTING DOCUMENTS RECEIVED PRIOR TO EFFECTIVE DATE OF INTEREST RATE INCREASE, OLD RATE OF 8-1/4 PERCENT WOULD APPLY.

2. BASIC RATIONALE FOR PROPOSED INTEREST RATE INCREASE IS HIGHER THAN ANTICIPATED AVERAGE COST OF BANK BORROWINGS IN PRIVATE CAPITAL MARKETS. IN PREVIOUS REVIEW OF BANK'S FINANCIAL POLICIES LEADING TO INCREASE OF INTEREST RATE TO 8-1/4 PERCENT AS OF SEPT. 3, 1974, BANK PAPER (DOC. R63-74) ASSUMED AVERAGE BORROWING COST TO BANK OF 8-1/4 PERCENT. NOW APPEARS TO BANK, AS RESULT OF EFFORTS TO RAISE REQUIRED CAPITAL IN PRICQXE MARKETS OVER PAST SEVERAL MONTHS, THAT AVERAGE BORROWING COST TO BANK WILL BE, AT MINIMUM, 8-3/4 PERCENT IN 1975 AND BEYOND. BANK PROPOSES, THEREFORE, INTEREST RATE TO BE INCREASED TO LEVEL EQUAL TO AVERAGE BORROWING COST, I.E. TO 8-3/4 PERCENT. IN ADDITION, BANK PROPOSES MORE AFFLUENT DEVELOPING MEMBER COUNTRIES BE REQUIRED TO PAY PREMIUM INTEREST RATE BASICALLY REFLECTING A FREE-OF-SUBSIDY LEVEL, I.E., A RATE FULLY INCLUDING ADMINISTRATIVE COSTS AS WELL AS AVERAGE BORROWING COST TO BANK, THE FORMER CALCULATED BY BANK AT 3/4 OF ONE PERCENT OF LOAN AMOUNT.

3. IN EFFECT, PREMIUM RATE ATTEMPTS TO RESOLVE ISSUE BETWEEN BANK AND U.S. WITH REFERENCE TO U.S. POSITION THAT ADB SHOULD TERMINATE FURTHER LENDING TO HONG KONG AND SINGAPORE. PRESIDENT INOUE FEELS OBLIGATED TO PROVIDE LIMITED RESOURCES TO THESE DEVELOPING COUNTRIES, LIMITED OFFICIAL USE

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YET FULLY RECOGNIZES REASONS FOR U.S. POSITION. HENCE, IN ATTEMPT TO STRIKE MUTUALLY ACCEPTABLE COMPROMISE, INOUE PROPOSES PREMIUM RATE TO HONG KONG AND SINGAPORE REFLECTING THEIR ADVANCED LEVELS OF ECONOMIC DEVELOPMENT. IN ADDITION, INOUE HAS ASSURED USADB THAT PROJECTS SO FINANCED IN THESE COUNTRIES WILL DEMONSTRATE HIGH DEGREE OF SOCIAL IMPACT WHICH, IN COMBINATION WITH PREMIUM INTEREST RATE, SHOULD HELP EASE U.S. DIFFICULTY

IN RESPONDING TO CONGRESSIONAL CRITICISM OF BANK  
LENDING TO HONG KONG AND SINGAPORE.

4. EVEN WITH INCREASED INTEREST RATE TO 8-3/4  
PERCENT (WHICH IS 1/4 PERCENT ABOVE ANTICIPATED  
NEW IBRD RATE AND, ALTHOUGH DOCUMENT DOES NOT STATE  
IT, IS BASIC REASON THIS PROPOSED RATELN BANK'S  
PROJECTED FINANCIAL INDICATORS SHOW CONSISTENT  
DECLINE THROUGH 1980. FOR EXAMPLE, INTEREST-COVERAGE  
RATIO DECLINES FROM 1974 LEVEL OF 2.46 TO 1.19 IN  
1980, FALLING BELOW THE 1.5 LEVEL IN 1977.  
RESERVE/LOAN RATIO DECREASES FROM 1974 LEVEL OF 0.22  
TO PROJECTED 1980 LEVEL OF 0.14 AND RESERVE/DEBT  
RATIO DECREASES FROM 1974 LEVEL OF 0.28 TO PROJECTED  
1980 LEVEL OF 0.12. HENCE, EVEN WITH PROPOSED  
INCREASE IN INTEREST RATE, BANK'S PROJECTED FINANCIAL  
INDICATORS DECREASE CONTINUOUSLY, IMPLYING THAT,  
UNLESS ADDITIONAL STEPS ARE TAKEN BY BANK, ADB  
WILL HAVE PROGRESSIVE DIFFICULTY IN RAISING FUNDS  
IN PRIVATE CAPITAL MARKETS AT REASONABLE RATES,  
ALL OF WHICH PARTICULARLY DISTURBING SINCE ADB  
COMPELLED TO RELY INCREASINGLY ON PRIVATE CAPITAL  
MARKETS FOR SOURCES OF LENDING FUNDS.

5. APPEARS TO USADB THAT BANK SHOULD CONSIDER SEVERAL  
ALTERNATIVES IN INTEREST OF REVERSING PROJECTED  
DETERIORATION IN ITS FINANCIAL INDICATORS: (A)  
FURTHER AND IMMEDIATE INCREASE IN LENDING RATE,  
IMPACT OF WHICH WOULD BE FELT IN 1979 AND BEYOND;  
(B) REDUCTION IN PROPOSED ELVEL OF FUTURE LENDING  
PROGRAMS WHICH (I) REDUCES BORROWING NEEDS AND,  
HENCE, (II) ALLEVIATES DOWNWARD PRESSURE ON BANK'S  
NET INCOME SINCE NET IMPACT ON BANK'S INCOME POSITION  
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FROM BORROWING VARIES DIRECTLY WITH AMOUNT OF  
BORROWING DUE TO NEGATIVE SPREAD BETWEEN LONG TERM  
BORROWING AND SHORT TERM REINVESTMENT RATES (ESTIMATED  
TO BE 3/4 OF ONE PERCENT); AND (C) INCREASED ATTENTION  
TO MAXIMIZING BANK RETURN FROM INVESTMENT OF SHORT-  
TERM LIQUID ASSETS. FYI: DOCUMENT ASSUMES ORDINARY  
CAPITAL LENDING OF \$450 MILLION FOR 1975, INCREASING  
AT \$50 MILLION/YEAR REPLENISHMENT TO BE IN PLACE BY END OF  
1977M END FYI.

6. LATTER TWO PROPOSALS PARA. 5 ABOVE SEEM REASONABLE  
AS WELL AS NECESSARY IF BANK AND MAJORITY OF MEMBER  
COUNTRIES UNWILLING TO CONSIDER FURTHER INCREASE  
IN LENDING RATE BEYOND 8-3/4 PERCENT. USADB CURRENTLY  
EXPLORING WITH BANK TREASURER STEPS NECESSARY TO

MAINTAIN INTEREST COVERAGE RATIO ABOVE 1.50  
GIVEN PROPOSED INTEREST RATE INCREASE TO 8-3/4 PERCENT.  
EFFORT ENTAILS BASIC ATTENTION TO EXTENT TO WHICH  
LENDING PROGRAM NEEDS DOWNWARD REVISION TO MODERATE  
IMPACT OF NEGATIVE INTEREST SPREAD ON NET INCOME  
POSITION AND INTEREST-COVERAGE RATIO.

7. USADB APPRECIATES NEED FOR INCREASE IN BANK  
LENDING RATE TO 8-3/4 PERCENT AT MINIMUM.  
PREPARED TO SUPPORT PROPOSAL BUT WILL URGE BANK TO  
MAKE ANY OTHER ALTERATIONS IN EITHER LEVEL OF  
LENDING ACTIVITIES OR MANNER IN CONDUCTING INVEST-  
MENT OF SHORT TERM ASSETS SUCH THAT DETERIORATION  
IN BANK FINANCIAL INDICATORS REVERSED IN VERY NEAR  
FUTURE. BANK MUST GIVE OVERWHELMING ATTENTION TO  
IMMEDIATE REVERSAL OF PROJECTED TREND IN FINANCIAL  
INDICATORS IF BANK TO BE ABLE TO BORROW IN PRIVATE  
CAPITAL MARKETS IN FUTURE YEARS IN SUFFICIENT  
QUANTITY AND ON SUFFICIENTLY ACCEPTABLE TERMS TO  
MEET REALISTIC LENDING PROGRAM.  
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## Message Attributes

**Automatic Decaptioning:** X  
**Capture Date:** 01 JAN 1994  
**Channel Indicators:** n/a  
**Current Classification:** UNCLASSIFIED  
**Concepts:** DEVELOPMENT BANKS, BANK RATES  
**Control Number:** n/a  
**Copy:** SINGLE  
**Draft Date:** 21 JAN 1975  
**Decaption Date:** 01 JAN 1960  
**Decaption Note:**  
**Disposition Action:** RELEASED  
**Disposition Approved on Date:**  
**Disposition Authority:** greeneet  
**Disposition Case Number:** n/a  
**Disposition Comment:** 25 YEAR REVIEW  
**Disposition Date:** 28 MAY 2004  
**Disposition Event:**  
**Disposition History:** n/a  
**Disposition Reason:**  
**Disposition Remarks:**  
**Document Number:** 1975MANILA00883  
**Document Source:** CORE  
**Document Unique ID:** 00  
**Drafter:** n/a  
**Enclosure:** n/a  
**Executive Order:** N/A  
**Errors:** N/A  
**Film Number:** D750022-0327  
**From:** MANILA  
**Handling Restrictions:** n/a  
**Image Path:**  
**ISecure:** 1  
**Legacy Key:** link1975/newtext/t19750134/aaaabdti.tel  
**Line Count:** 190  
**Locator:** TEXT ON-LINE, ON MICROFILM  
**Office:** ACTION TRSE  
**Original Classification:** LIMITED OFFICIAL USE  
**Original Handling Restrictions:** n/a  
**Original Previous Classification:** n/a  
**Original Previous Handling Restrictions:** n/a  
**Page Count:** 4  
**Previous Channel Indicators:** n/a  
**Previous Classification:** LIMITED OFFICIAL USE  
**Previous Handling Restrictions:** n/a  
**Reference:** n/a  
**Review Action:** RELEASED, APPROVED  
**Review Authority:** greeneet  
**Review Comment:** n/a  
**Review Content Flags:**  
**Review Date:** 11 JUL 2003  
**Review Event:**  
**Review Exemptions:** n/a  
**Review History:** RELEASED <11 JUL 2003 by CunninFX>; APPROVED <14 NOV 2003 by greeneet>  
**Review Markings:**

Margaret P. Grafeld  
Declassified/Released  
US Department of State  
EO Systematic Review  
05 JUL 2006

**Review Media Identifier:**  
**Review Referrals:** n/a  
**Review Release Date:** n/a  
**Review Release Event:** n/a  
**Review Transfer Date:**  
**Review Withdrawn Fields:** n/a  
**Secure:** OPEN  
**Status:** NATIVE  
**Subject:** PROPOSED INCREASE IN ADB ORDINARY CAPITAL LENDING RATE SUMMARY: ADB MANAGEMENT PROPOSES INCREASE IN ORDINARY  
**TAGS:** EAID, EFIN, ADB-1, USADB  
**To:** STATE  
**Type:** TE  
**Markings:** Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 05 JUL 2006